



Montana Department of Revenue



Memorandum

To: Mike Kadas, Director

From: Dan Dodds, Senior Economist

Date: May 19, 2015

Subject: Small Business Impact Analysis for the proposed new rules, amendments to ARM 42.15.108 and 42.15.301, and repeal of ARM 42.15.407 and 42.17.316 contained in MAR 42-2-931.

These proposed rule changes relate to filing requirements for estates and trusts and calculation of income for these entities. My conclusions on small business impacts are as follows:

- a) Estates and trusts are not entities that meet the definition of small business in 2-4-102(13), MCA. Beneficiaries of estates and trust are generally either individuals or charities. In the limited cases where a business entity can be a beneficiary, it is almost certain not to meet the definition of a small business.
- b) Returns for estates and trusts are filed by fiduciaries. Fiduciaries generally are individuals or financial institutions, but an unknown number may meet the definition of small business.
- c) Changes in the costs of tax compliance due to these rules are minimal.
- d) These rules may either increase or decrease tax on some estates, trusts or beneficiaries, but the affected beneficiaries are almost certain not to be small businesses.

Estates and trusts are legal arrangements under which one party, called the trustee or fiduciary, holds assets for the benefit of another party or parties, called the beneficiaries. In general, estates and trusts are not business entities within the meaning of 2-4-102(13), MCA. Fiduciaries may be individuals or business entities, such as the trust department of a bank. An individual or institution may serve as fiduciary for more than one trust or estate. There are approximately 10,000 returns filed each year for estates and trusts by about 7,000 fiduciaries. It is impossible to tell from the returns how many of these fiduciaries are small businesses as defined in 2-4-102(13), MCA.

The proposed rules are primarily informational rather than substantive. Sections 15-30-2151 through 15-30-2153, MCA set the taxation of the income of estates and trusts. In general, the income of an estate or trust is taxed as if it were the income of an individual,

with exceptions and adjustments spelled out in these sections and elsewhere. This means that specific requirements, such as filing requirements, that apply to estates and trusts are scattered throughout Title 15, Chapters 30 and 31. For the most part, the proposed rules gather these requirements into one spot and explain how they apply to estates and trusts.

Three of the rules represent substantive changes.

New Rule VII requires the calculation of Montana net operating loss, which may be different from the net operating loss calculated on the federal return. This is consistent with the requirement for individuals, and with the department's past practice. However, in the absence of this rule, the department has instructed some fiduciaries to use the unadjusted federal net operating loss.

New Rule IX allows the fiduciary of multiple pre-need funeral trusts who files a composite federal return for multiple trusts to file a composite state return for the same trusts. This is common practice for these fiduciaries, but is not explicitly authorized by existing law or rules.

New Rule X makes Montana treatment of an electing small business trust (ESBT) consistent with federal law and regulations. An ESBT is a trust that can hold S corporation stock placed in the trust by gift or bequest. Federal law and regulations require that an ESBT with S corporation stock and other assets be taxed as two trusts, one on the income from S corporation stock and the other on all other income.

These three changes will not significantly increase fiduciaries' costs of complying with the income tax and may reduce those costs in some cases. In some cases, New Rules VII and X may either increase or decrease tax owed by a trust or its beneficiaries. However, the beneficiaries of an ESBT must be either a natural person or a charity. A company can be the beneficiary of some kinds of trust, but this is rare, and it generally is done to isolate the portion of a company's assets that are to be used as collateral in a complicated securitization arrangement. These securitization arrangements generally involve large companies rather than small businesses.

Thus, few if any small businesses will be adversely affected by these rules.